



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE EO Examinations

MS:4957:DAL

1100 Commerce Street

Dallas, TX 75242

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

MAR 01 2010

Number: **201040034**

Release Date: 10/8/2010

ORG

ADDRESS

UIL: 501.10-00

Taxpayer Identification Number

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear :

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter modifying or revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

In lieu of Letter 3610

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Acting Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018-A
Report of Examination
Envelope

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LEGEND

ORG = Organization name XX = Date EIN = EIN City = city
State = state President = president BM-1 = 1st BM CO-1 = 1st CO

ISSUE

Whether ORG is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(10).

FACTS

ORG (hereinafter "ORG") whose Employer Identification Number is EIN, was incorporated on September 20, 20XX. ORG was recognized as an organization exempt from federal income tax as described in IRC Section 501(c)(10) under the group ruling number 9470. ORG maintained liquor license to sell liquor by the drink for a tax exempt entity.

In Chapter 311, Section 311.090 of the State Revised Statutes, Liquor Control Law, "in order for a licensee to sell intoxicating liquor outside city limits, a licensee must meet certain provisions such as having obtained an exemption from the payment of federal income taxes as provided in IRC sections 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(7), 501(c)(8), 501(c)(10), 501(c)(19), or 501(d) of the United States Internal Revenue Code of 1954, as amended in any incorporated city having a population of less than 19,500 inhabitants as determined by the last decennial census under the provisions and methods set out in this chapter." Also, in Chapter 311, Section 311.097 of the State Revised Statutes, Liquor Control Law states "that an organization can obtain a license to sell liquor by the drink if at least 50% of the gross income of which is derived from the sale of prepared meals or food consumed on such premises or which has an annual gross income of at least \$\$ from the sale of prepared meals or food consumed on such premises.

ORG was created by President. Several customers asked about the bar being open on Sunday prior to the organization becoming ORG. As an S-corporation the bar could not be open on Sunday. In the state of State, only an exempt organization is allowed to be open on Sunday. Therefore, the organization contacted the CO-1 in City, State, and inquired about information on how to become a ORG subordinate. President received an information packet which included basic information on how to form a corporation and applications to apply for a ORG subordinate. The organization became a ORG subordinate in September 20XX.

The parent organization's Constitution and Bylaws state that ORG purpose is "to promote fellowship among all living beings, respectfully; to encourage the elimination of prejudice and help unify divergent groups in the overall interest of American democracy; to orientate our youth with full knowledge of responsibilities as well as

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privileges of citizenship through the wisdom of our seniors; to assist the underprivileged and well deserving by maintenance of sponsoring educational opportunities and by providing monetary grants and awards toward their wellbeing overall; to fully support the effort of "Drug Free America;" to encourage compassion for every fellow man, woman and child in distress and/ or deserving; to provide social clubs for members and guests for the purpose of fellowship and entertainment of its members; to create and initiate new programs to assist the homeless, battered and abandoned children, the mentally retarded, and the needy and well deserving for the purpose of their well-being."

Requirements to become a ORG's subordinate are as follows:

1. Start the chapter with 25 members at annual dues of \$\$ each. By the seventh year of incorporation the subordinate is required to have 32 members. The dues will be split 50/50 between the parent organization and subordinate for each membership sold after 32.
2. Donate \$\$ to other approved non-profit entities. All donations must be verified by providing the CO-1 copies of canceled checks submitted for donations. If donations are given to needy individuals, subordinate must submit the name of the individual, social security number, date of birth, address, the reason for the donation, and the amount of the donation.
3. Conduct monthly meeting

Article III, part 4 of the Articles of Incorporation states that, each ORG USA post/lodge will be committed to contribute \$\$ each year to charity(s) of the post/lodge choice. These charities may be within the post's own community. Verification of donations must be submitted to the CO-1 monthly to be placed in each post/lodge file. During the year under the examination, ORG had benefits for local charities by having fundraising events and participating in a Food Drive.

Since President's inception with the ORG, his business has been able to be open on Sunday, because of his organization's exemption from Federal income tax under IRC 501(c)(10) as a subordinate ORG. From September of 20XX to August 20XX, ORG was open to the general public to recruit new members. Currently, the organization has a 3 visit maximum policy. Guest can come to the bar 3 times then must apply for membership. During the course of the examination, the organization posted a sign in the organization that stated restricted to members only. The organization did this to be exempt from state sales tax, because ORG is not recognized as an exempt organization with the State Department of Revenue.

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The organization must be restricted to members only in order to be exempt from sales tax.

There is a complete lack of regalia or memorabilia specific to the ORG either inside or outside the organization. The organization is devoid of any rites or rituals specific to the ORG culture when the meetings are held or when new members are recruited. Any individual who pays the \$\$ for membership can join the organization. There is no common bond among interest and demonstrated in the open membership. ORG has only one class of membership and there are approximately 100 members.

LAW

Internal Revenue Code subsection 501(c)(10) provides an exemption for domestic fraternal societies, orders, or associations, operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and which do not provide for the payment of life, sick, accident, or other benefits.

Income Tax Regulation section 1.501(c)(10)-1 provides that an organization will qualify for exemption under section 501(c)(10) if it is a domestic fraternal beneficiary society order, or association, described in section 501(c)(8) and the regulations thereunder except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

Internal Revenue Code section 501(c)(8) provides an exemption from taxation for fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Rev. Rul. 81-117, 1981-1 C.B. 346 states that an organization that does not conduct any fraternal activities or operate under the lodge system, but does operate exclusively for the benefit of members of certain related domestic fraternal societies operating under the lodge system, does not qualify for exemption under section 501(c)(10) of the Code.

Rev. Rul. 73-165, 1973-1 C.B. 224A defines a fraternal beneficiary society, order, or association exempt under section 501(c)(8) as one that, in addition to being operated in furtherance of fraternal purposes, (1) is so operated under the lodge system or for the exclusive benefit of the members of a fraternity that is so operated under the lodge system, and (2) has an established system for the payment to its members or their dependents of life, sick, accident, or other benefits. There is no requirement that

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either the fraternal features or the insurance features predominate so long as both features are present.

In *National Union v. Marlow* 374 F. 775, 778 (1896) a fraternal beneficial society was defined as one whose members have adopted the same, or a very similar calling, avocation, or profession, or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling, or profession usually has a tendency to create a brotherly feeling among those who are thus engaged. The National Union did not fit this definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that: *"In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan."*

The court in *Polish Army Veterans Post 147 v. Commissioner*, 24 T.C. 891, reversed on other grounds, 236 F.2d 509 (3rd Cir. 1956) concluded that an organization had not established its exemption as a fraternal beneficiary society because members lacked a common tie: to qualify for the exemption an organization must be fraternal Here only the active members, comprising less than 10 per cent of the total membership of the Post, had a common tie. They, of course had the bond of having formerly served in the Polish Army. But approximately 90 percent of the total membership of the Post was social members who were not ex-members of the Polish Armed Forces and who ... had nothing in common with the active members or with each other. An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization.

Fraternal Order of Civitans v. Commissioner, 19 T.C. 240 (1952) provided that the requirement of common ties and objectives is not satisfied merely by a recitation of such purposes in the association's constitution or bylaws. It is necessary that the stated purposes be implemented or accomplished by specific acts. The Tax Court denied exemption to an organization whose constitution called for, among other things, the promotion of civic enterprises in the community. It engaged in no civic or charitable activities during the period under review.

The court in *Western Funeral Benefit Association v. Hellmich*, 2 F.2d 367 (E.D. Mo. 1924), stated that "by the 'lodge system' is generally understood as an organization

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which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to ritual."

Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926), held that where the sole motive in joining an organization is to receive insurance benefits, and there are no lodges, rituals, ceremonies or regalia, then there is no fraternal element present.

Knights of Columbus Building Association of Stamford, Conn., Inc. v. United States, 61 AFTR 2d 88-1212 (DC Conn. 1988), held that an organization that operated a bar and buffet that was utilized by nonmember community organizations was not operating with the exemption provisions and therefore was not exempt under IRC §501(c)(8).

TAXPAYER'S POSITION

The Taxpayer's position is unknown at this time.

GOVERNMENT'S POSITION

ORG is not a domestic fraternal society because the members do not have a common tie or objective. The only common bond between the members is their membership in ORG. Members of ORG do not have a common fraternal bond. The members do not possess a similar calling, avocation, or profession, and are not working in unison to accomplish any worthy objective or common cause. Rituals, ceremonies, and regalia that are evidence of fraternal activities are not found in ORG. ORG has not been neither operating for religious, charitable, scientific, literary, educational and fraternal purposes, nor devoting its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The current officer, BM-1, created ORG and purchased the facility with the intent to profit on the investment. All assets and net earnings of ORG belong to the owner, President.

ORG is not operating under the lodge system. ORG is a member of the parent organization through the payment of dues and a charter fee. The annual membership dues are paid by ORG, not the members. The term "membership dues" implies that each member pays a fee for membership because they place a value on their association with the organization and that there are rights, privileges or benefits associated with membership. The organization does not have a set meeting schedule and there are no rituals associated with the meetings. The organization does not have a representative form of government because the members have no voice or voting rights in the business operation of the organization or the net earnings. The officer is not selected or elected by the membership.

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During the year under audit, although ORG had a fundraising to raise money to help local charities, that does not continue to qualify ORG for exemption under 501(c)(10). ORG is operating in a commercial manner which is not an exempt activity described under Internal Revenue Code section 501(c) (10).

CONCLUSION

In the case of ORG, it is held that, where the primary purpose or activity of the organization is the commercial manner in which the bar operates. ORG is not a domestic fraternal society operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The organization does not qualify for exemption under section 501(c)(10) of the Internal Revenue Code. Consequently, the organization's exempt status is revoked effective September 1, 20XX.

Forms 1120 should be filed for the tax periods ending on and after June 30, 20XX.